A Survey of Surveys: Salary Plans

	Level of Employee	1985 Salary Increase	1986 Planned Salary Increase
American Compensation Association	Executive	6.7%	6.5%
	Exempt Salaried	6.4	6.2
	Nonexempt Salaried	6.2	6.1
The Conference Board	Exempt Salaried	6.0	6.0
Executive Compensation Service, Inc. A Subsidiary of The Wyatt Company	Executive	6.0	6.0
	Exempt Salaried	6.0	6.0
	Nonexempt Salaried	6.0	6.0
A. S. Hansen	Executive	6.3	6.3
	Exempt Salaried	6.2	6.1
	Nonexempt Salaried	6.0	6.0
Hewitt Associates	Executive	6.3	6.1
	Exempt Salaried	6.0	5.9
	Nonexempt Salaried	5.7	5.7
Sibson & Company	Executive	6.8	6.3
	Exempt Salaried	6.4	6.1
	Nonexempt Salaried	6.3	6.2

For the third consecutive year, planned salary increases are generally slightly lower than the average increase in the prior year.* However, the continuation of the present low rate of inflation would mean a real earnings gain for employees. (The Conference Board model of the U.S. economy projects the Consumer Price Index to rise 3.4% this year and 3.5% in 1986.) The modest salary increases planned for 1986 seem to indicate continued determination on the part of employers to control their compensation costs.

Charles Peck
Senior Research Associate
The Conference Board

*The actual change in pay over the previous year's ending payroll is usually about two percent less than the anticipated average increase.

agreed to regional bargaining, and our discussions with Bell Atlantic are promising.

"Perhaps the most drastic change in human resource policy which occurred as a result of the restructuring of AT&T was a shift in the attitude of the company toward the union. CWA and AT&T had grown and prospered together for 30 years, but following divestiture, several of the new Regional Holding Companies took a strong anti-union stance. Most of the RHCs have set up non-union subsidiaries and are vigorously opposing attempts to transfer to the subsidiaries by CWA to organize these workers. Organized workers who wish to transfer to the subsidiaries are required to quit their jobs in the organized, regulated side of the business before being hired by the new company. Many of the RHCs are also fighting CWA over the structure of 1986 contract negotiations. They want the union to negotiate separately with each of the local telephone subsidiaries, while we would prefer to bargain with the central decision-making organization.

"Bargaining with AT&T should look very much the way it did in the past, except that the size of the work force has dropped from approximately 500,000 to 200,000. Bargaining will be on a national basis, and, despite the recent layoffs, relations with the company are good.

"The picture at the Bell Operating Companies is quite different. They are much more profitable than AT&T, and we expect a fair share of the profits. Our first goal will be to achieve regional bargaining. If the regional companies refuse to bargain on this basis, we will select one company as the pattern-setter and insist that all others accept the same settlement before the 'pattern' contract is signed. For example, there will be no settlement within the Ameritech region until we have a settlement in all five operating companies.

"Another important goal in our bargaining with the Bell Companies is improved transfer rights within the regional companies. The regional companies are hiring new employees off the street for their unregulated subsidiaries while laying off CWA members from the regulated Bell Operating Companies. They refuse to transfer our laid-off members because they would automatically carry contract protections with them under the divestiture consent decree."

Steel bargaining may result in a number of "early" settlements, perhaps even before the Steelworkers negotiate with the can (February) and aluminum (May) industries. Bill McCann wrote:

"If no additional protectionist legislation involving the steel industry is adopted by the time bargaining commences, the pressure will be on the management and the USW to develop constructive solutions for survival. Under these circumstances, I would expect individual bargaining by those steel companies designed to differentiate their contracts by product and/or location. The union may attempt to maintain some type of pattern conformity between companies where there are similar circumstances, but will be more cognizant of the need for differentiation.

"The end result will depend on the members' perception of their employer's financial and competitive condition, and their willingness to make the necessary wage and work rule adjustments to ensure their continued employment and job security. This perception may vary widely among companies, and among different plant locations. It certainly places the responsibility for effective communications squarely on management's shoulders."

Union contracts may not provide that "one big number" that affects wage expectations throughout the economy, Dan Mitchell noted, but they have an impact on national averages. This is because union hourly wages, on average, are higher. Generally, the union weight in the average hourly earnings data is about one third. He went on:

"When you look down the list of upcoming contracts for 1986 you find some in lumber and paper, steel and cans, machinery, telephones, longshore (East Coast ILA), some retail foodstores and construction. Lumber and paper and steel and cans have been concession centers—as has machinery. Foreign trade problems will act as a drag on wage settlements in these industries in 1986. It would take a massive dollar devaluation to turn that situation around.

"The telephone industry contracts will be the first after the AT&T split-up. The CWA will have enough problems trying to coordinate the various settlements. Moreover, while the core of the local operating companies is still a regulated monopoly, there is a lot of nibbling on the margin and nonunion competition. Thus, the at-

Table 2: Selected Major Contract Expirations by Industry, 1986

Month of Contract Expiration	*Industry*	*Company*	*Union*
January	Oil	Major companies	Oil, Chemical and Atomic Workers
	Tobacco	Philip Morris, Inc.	Bakery, Confectionery and Tobacco Workers
	Food	Hawaii Sugar Cos.	Longshoremen
February	Retail Trade-Food Stores	Food Employers Council of No. California Food Employers Labor Rels. Council (Santa Clara)	United Food and Commercial Workers
	Fabricated Metals	Continental Can, American Can, National Can	Steelworkers
March	Communications	General Telephone Co. of Cali.	Communications Workers
	Health Services	Greater NY Health Care Facilities Association	Service Employees
	Glass	Owens-Illinois Anchor Hocking Brockway	Glass, Pottery, Plastics, & Allied Workers
April	Construction	Local multiemployer contracts expire throughout April-June	Construction craft unions
May	Lumber and wood products	Western States Wood Prods. Employers Assn.	Woodworkers
	Primary metals	Aluminum Co. of America Reynolds Metals	Aluminum, Brick and Glass Workers; Steelworkers

Table 2: Selected Major Contract Expirations by Industry, 1986 (continued)

June	Machinery	Caterpillar Tractor Co. Deere & Co.	Auto Workers
	Electrical, gas, and sanitary services	Consolidated Edison	Utility Workers
	Health Services	League of Voluntary Hosps. & Homes of NY & Other	Retail, Wholesale and Dept. Store Union
	Shipbuilding	Pacific Coast Shipbuilders	Metal Trades Council
July	Primary Metals	Wheeling-Pittsburgh Steel	Steelworkers
	Transportation Equipment	Pacific Coast Shipbuilders Assoc.	Various
	Machinery	Rouge Steel Co. Briggs & Stratton Corp.	Auto Workers Allied Industrial Workers
August	Primary Metals	Armco Inc. Jones & Laughlin Steel Corp. Republic Steel Corp. Bethlehem Steel Co. U.S. Steel Corp. National Steel Corp. Inland Steel Co.	Steelworkers
	Machinery	Timken Co.	Steelworkers
	Electrical machinery, equip. and supplies	Western Electric	Electrical Workers (IBEW), and Communications Workers
	Communications	AT&T, Long Lines Operating cos. including: Bell South Chesapeake & Potomac Michigan Bell Northwestern Bell Ohio Bell, etc.	Communications Workers
		New England Telephone and Telegraph Co. Bell Telephone Co. of Pa. Plant Department NJ Bell Telephone Illinois Bell Telephone	Electrical Workers (IBEW)
September	Retail trade	Waldbaum, Bohack, Daitch, others	Retail, Wholesale & Dept. Store
	Hotels	Casino Hotels of Atlantic City	Hotel Employees
	Shipping	Atlantic & Gulf Coast Shipping Assns.	Longshoremen
October	Transportation equipment	Boeing Co. Lockheed Aircraft Corp. McDonnell-Douglas Corp.	Machinists and various independent engineering unions
	Transportation	Greyhound Lines	Amalgamated Transit Union
	Air transportation	United Airlines-Ground Serv.	Machinists
	Retail trade	Jewel Food Stores	Food & Commercial Workers
December	Building Services	N.Y. Realty Advisory Board	Service Employees
	Transportation equipment	Dana Corp.	Auto Workers

Source: U.S. Bureau of Labor Statistics; Bureau of National Affairs.

mosphere does not seem right for a large wage settlement. Retail food and construction are two sectors that have had many concession deals, even though foreign trade and deregulation are not relevant. They seem to be working off past union/nonunion wage differentials. Unionization has fallen in construction. It's hard to get comparable data for supermarkets, but there seems to be nonunion competition coming into retail foodstores (or lower-wage union competition). There has been much two-tiering in retail food. If the UFCW wants to get rid of it, it will be hard pressed to obtain large general wage adjustments. And if it doesn't get rid of it, growing proportions of workers in the lower tier will tend to lower the average wage anyway.

"Longshoring is always volatile. But there are reports of nonunion and lower-wage union ports in the south which will put a damper on settlements in other ports.

"All in all in the union sector, it is hard to see sources of general wage pressure. Even if the wage freezes and cuts become less common (there has been some downward trend in these), there will not be any 'wage push' here.

"We now come to the nonunion sector. Nonunion wages have been outpacing union wages recently, a reversal of the pattern in the 1970s. Given the downward shift in the union wage norm which has occurred this pattern could well continue. But what is there that would suggest a significant acceleration in nonunion wages, which have traditionally been more market sensitive than union? The rate of price inflation is not likely to change much. Nor is the unemployment rate.

"One possibility that has been suggested for wage pressure is an alleged shortage of young, entry-level workers for demographic reasons. Indeed, the number of full-time workers in the 16-24 year age range fell slightly from 1984-II to 1985-II, according to the Current Population Survey. But that same survey reveals that 'usual' weekly wages for these younger workers rose more slowly than for older workers during that period. These data are very imperfect, since changes in 'usual' weekly hours may affect the results. But the point is that no signs of a youth labor shortage leap out from the available numbers.

"In summary, if you start with the question 'Why should the rate of wage increase be much different in 1986 from what it was in 1985?'—the answer is 'no reason.' "

The use of once-a-year "lump sum" payments, in lieu of wage increases, is spreading rapidly. The panel thinks that the practice will continue to grow, even though unions prefer wage rate hikes. (Lump sums do not establish a new and higher wage level, from which the next increase is bargained. Moreover, they need not raise the cost of wage-related benefits such as time off. Finally, they present a noticeable amount in a check to the worker.) Dan Mitchell suggested that if a few lump sums were made contingent, flexing in amount with some company performance measure, they would become the union version of true pay-for-performance. If this happened, a union pay package or formula might be more linked to company performance than its salaried workers' compensation.

Tax Changes

There will be no taxation of health benefit premiums paid by the employer, the panel agreed. It was also in general agreement that 401-K plan contributions will retain their tax deferral. However, lower caps on the amount of salary that can be deferred may emerge, and much tighter restrictions and penalties for withdrawal prior to retirement. This move will force a new executive compensation policy for top-paid ranks—probably non-qualified, non-ERISA protected plans.

As Bill McCann observed:

> "One out of four workers is presently covered by a 401-K plan, and their growth has been spectacular in the last year or two, with average participants saving about 5% of their salaries. Barring changes in the tax law allowing interest income to be tax exempt, development and expansion of 401-K plans is a step in the right direction to encourage increased personal savings and development of capital. However, it is more probable that contribution limits will be restricted, especially for higher salaried employees, and more strict withdrawal penalties imposed.
>
> "In light of the more controversial provisions of the various tax bills, it seems probable that these areas would become subject to compromise as part of a bigger negotiated package. The potential buildup of tax-free money involved in a 401-K plan is too much to go unnoticed by legislators looking to 'enhance revenues' as a major solution to the budget deficit problem."

In Summary...

The most important fact about this outlook for 1986 is that it does not envisage a turning point in the economy. The sense of slow growth—even stagnation—is there. The sense that the U.S. economy is in a risky position is there. But The Conference Board's 1986 Labor Outlook does not expect a recession. Therefore, its projections for unemployment are flat at current levels. In fact, the entire picture is steady, with slow growth of productivity continuing.

ALAN EWALT

The Conference Board
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The 1986 U.S. Economic Outlook: Comfortable but Frail

Summary of a meeting of
The Conference Board Economic Forum

Management Summary

- The Forum consensus paints the 1986 outlook in pastel hues: comfortable and subdued. From now to late next year, economic activity is expected to climb 3 percent and the general price level 4 percent, while interest rates hold at or near present levels.
- Until the dollar falls a lot farther, the two-track pattern of the 1985 economy—with manufacturing, mining and agriculture under heavy pressure from foreign competition, while construction and services do quite nicely—is likely to continue.
- Gramm-Rudman-Hollings has sharp teeth that, whenever the time comes, are going to bite painfully into Federal spending. Whatever comes out of this attempt to curb the deficit seems sure to include plenty of economic and financial turbulence.
- Any damage that these and other uncertainties might create does not appear to be imminent. Prospects for 1986 do, therefore, look favorable. Yet, there are many frailties in the economy that could seriously undermine the comfort people now feel about the outlook.

Economic and Policy Analysis Program

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A Goldilocks Economy

Edgar R. Fiedler

The November meeting of The Economic Forum produced a very comfortable, middle-of-the-road outlook for the U.S. economy in 1986. A careful perusal of the discussion, however, reveals many important dimensions of fragility and vulnerability.

The numerical forecasts (table, page 4) show reassuringly favorable expectations for continued steady expansion and moderate inflation. The median forecast calls for a bit over 3-percent growth in economic activity, about a 4-percent climb in the general price level, profits advancing 7 percent, and interest rates flat. In many ways this is a rather happy outcome. Just as Goldilocks found a porridge that was not too hot and not too cold but was *just right*, so do we foresee an economy with enough heat to reduce unemployment slightly, but not enough to trigger an inflationary blow-out.

As always, the average projections hide some marked differences among the individual forecasts. At the low end of the outlook, a 2-percent advance during 1986 would be pretty sluggish. But at the top end, 4½-percent growth would make for a fairly lively economy, with better profits and modest additional pressures on inflation and interest rates. As these forecast surveys go, however, the range of views surrounding the consensus is fairly tight.

The continuing expansion in economic activity is being fueled by moderate advances in every major sector, rather than by just one or two powerful components pulling the rest along. In the household sector, for example, Allen Sinai noted that: "Consumers can no longer be the driving force of economic expansion." Nevertheless, they will continue to pull their weight. The automobile industry, after selling almost 11 million cars in 1985, is bound to see a retrenchment. But if 10.5 million cars are sold next year, as we estimate, 1986 will still be a very good year. Overall, consumer outlays should continue on the upgrade. Spendable income will rise further in 1986 and, with consumer psychology still favorable, retail sales won't be far behind. The public, Amitai Etzioni reported, is in an unusually good mood and, while that normally doesn't last too long, it supports the outlook while it does last.

Prospects for home construction are fair. New housing permits have been rising but at today's mortgage-interest rates, Lyle Gramley pointed out, there is little basis for anticipating a marked improvement in housing production. Tighter standards by mortgage bankers will limit further gains, and 1986 should see about the same number of new starts as 1985—an estimated 1.75 million units.

Business capital formation is expected to support—but not lead—the economy in 1986, with an advance of about 4 percent. The big stories in the investment sector, however, are not in the totals but in their composition. One dramatic shift in the industry is the explosive advance of computers and related "high-tech" equipment, which now account for 49 percent of total capital equipment spending—up from 27 percent just 10 years ago. In 1986, computers and similar equipment should again account for the lion's share of the overall advance in capital goods outlays.

Edgar R. Fiedler

Many frailties undermining the comfort.

A second startling change is seen in the inroads of foreign competition. Since 1980, exports of capital goods have dropped from 27 percent of U.S. shipments to about 20 percent, while imports have climbed from 14 percent of U.S. purchases to 25 percent. As a result, virtually all of the 25 percent gain in U.S. capital goods purchases has been lost to foreign sources. In 1986, although the "high-tech" manufacturers should do well, other U.S. producers are again likely to find it tough to hold their own.

These generally favorable prospects, plus further gains in defense and state and local government spending, add up to something like a 3-percent uptrend for the economy as a whole. Thus, with inflation holding at an unmenacing level, and unemployment inching downward, the economic picture for 1986 looks reasonably bright.

The Uncertainties

What these innocent numbers do not reveal, however, are the many anxieties and qualifications that accompany the forecasts. One of the uncertainties within the economy is the viability of the debt structure. In general, members of the Forum do not feel the consumer-debt burden threatens serious problems, at least not until there is trouble on the job front. Little comfort is taken, however, from debt conditions in agriculture and the developing countries. A second source of concern is the two-track pattern of the economy, with those industries subject to intense foreign competition from the burden of the high dollar (mostly in manufacturing, mining and agriculture) being bruised rather badly, while construction and services are doing quite nicely. Until the dollar falls a good bit farther, this two-track pattern will continue.

Still other worries arise from the international side. Slow growth abroad continues to put a drag on expansion here at home. A more dramatic possibility would be a loss of appe-

THE FORUM CONSENSUS
Results of a Pre-Meeting Outlook Survey

	Actual 1984	Estimated 1985	Projected Fourth Quarter 1985	Projected 1986 Median	Projected 1986 Range
Economic Growth (Real GNP, percent change)	5.7	2.1	3.5	3.2	2.0 to 4.5
Inflation Rate GNP Deflator, percent change)	3.6	3.6	3.3	4.2	3.1 to 4.9
Corporate Profits (After taxes, percent change)	0	– 2	3	7	–5 to 20
Unemployment Rate (Percent, average during fourth quarter)	7.2	7.0	7.0	6.8	6.4 to 7.5
Commercial Bank Prime Rate (Percent, average during fourth quarter)	11¾	9½	9½	9½	8.5 to 12

	Actual FY 1985	Projected FY 1986	Projected FY 1987
Federal Budget Deficit (Billions of dollars)	212	192	182

Note: These forecasts incorporate submission by Forum participants in early November, and are based on data available at the time. For growth, inflation and profits, the annual forecasts are the percent change over the four quarters of the year, i.e., from 1985 IV to 1986 IV; the forecasts for the fourth quarter of 1985 are at seasonally adjusted annual rates.

tite by foreign investors for U.S. securities, which could bring on an upsurge in interest rates that would turn the expansion into a 97-pound weakling. The accompanying sharp drop in the exchange value of the dollar would have the opposite effect on prices, that is, it would turn the near-calm of today into an inflationary windstorm. Finally, there is a more subtle anxiety about the increasing dissatisfaction and political resentment about the United States that is being felt throughout the world. In general, our military and economic might is respected, but foreigners are not at all sure we know how to use our power wisely.

A third set of concerns centers around government policies. Gary Wenglowski expressed doubts that anyone really knows how to measure the thrust of policy in a world of floating exchange rates. If other major nations have fixed their fiscal policies at too restrictive a setting, he worried, perhaps our deficit should not be reduced without international coordination. Protectionism is also a source of nervousness, although most members of the Forum feel that, one way or another, the United States will avoid enacting major protectionist legislation this year or next.

The greatest uncertainty surrounds the Gramm-Rudman-Hollings initiative to reduce the deficit, now being debated in Congress. This legislation has a political steamroller behind it, and is likely to become law in one form or another. If so, the teeth built into this law are going to bite painfully. In its mildest form so far, the bill would require $20 billion more in spending cuts than all cuts previously proposed. Since even the earlier proposals far exceeded the public's taste for program reductions, when (and if) the new legislation takes hold, the complaints would come from every point on the political spectrum. Indeed, the screams would be deafening and overwhelming.

The ensuing political brouhaha would be a beaut! How it might get sorted out is anybody's guess. The Forum's guess is that in the end the leadership of the House and Senate would negotiate a compromise with the President that would include (1) a relaxation of the deficit target, (2) moderate cuts in both military and social spending, and (3) a tax increase, perhaps a "business transfer tax" (a form of sales tax). But whatever comes out of Gramm-Rudman-Hollings, it is sure to include plenty of political, economic and financial turbulence.

A further uncertainty about policy is the future of tax reform. The chances of a major restructuring of the tax system fade a little more with each passing day, partly from all the specific pressures lined up against the idea and partly from the fight over deficit reduction. President Reagan's trips around the country were unsuccessful in generating a groundswell of support for his package of reform. Some type of "tax reform"—featuring a stiff minimum tax on both individuals and corporations—*will* be enacted; that much must happen for image and face-saving reasons. But the final bill will not

represent significant reform relative to what has been discussed throughout 1985.

Conclusions

What does all this mean for the financial markets? Prices of both stocks and bonds have been rising all year, but without bringing peace of mind to the financial community. Indeed, the rising markets appear to have produced only rising anxiety: anxiety about excessive leverage, about the wild fluctuations that are now so common for individual issues, about the many new capital-market instruments not yet tested by adversity, about a sharp drop in the dollar, about too much strength developing in the economy, and about the unknown impact of Gramm-Rudman-Hollings. All are perceived as serious threats to financial equanimity. "The word from the equity markets is *unease,*" Bob Wade told us.

But while all these uncertainties, some of which are of alarming proportions, are present, they remain possibilities rather than probabilities. Those that do materialize could turn out to be less damaging than advertised. Furthermore, few if any of these threats appear to be imminent. In the final analysis, then, economic prospects for 1986 do, in fact, look quite agreeable. Equally important, however, are the many frailties in the economy, which work against robust expansion and which, as 1986 unfolds, could seriously undermine the comfort people feel about the outlook.

Political and Social Trends

Amitai Etzioni

Amitai Etzioni

Watch out for BTT, son of VAT!

And now, watch out for the BTT! The BTT? Yes, BTT, the son of VAT! The sociopolitical climate may be right next year for the public discussion and, possibly, the enactment of a business transfer tax. The BTT, which has been crafted by Senator William V. Roth, would be imposed on all domestic business transactions, with special provisions to exclude "essential items" (food, medicine) and to cover imports. At a 10-percent level, BTT is estimated to kick in $78 billion (assuming a FICA and federal income-tax "credit") annually to the Treasury.

BTT's star may rise for some obvious and some not-so-obvious reasons. Most obviously, it would serve to reduce the still gigantic deficits, as the taste for cutting social programs or defense is being exhausted in the country and in Congress. The fact that BTT also serves as a tax on imports adds to its appeal.

Less obviously, the tax-reform bill, which is widely expected to be enacted in some form, will shift part of the burden of taxation from individuals to corporations. (While the proportion of total revenues garnered from corporations will remain at an historically low point, and while tax rates for both individuals and corporations are expected to be lowered, corporations will lose more from various other changes in the code and, hence, their net tax payments are expected to rise.) BTT, a tax that sounds as if it is imposed on businesses but actually is a sort of sales tax, will work to tilt the system back in the direction it was leaning before the 1985 push for tax reform.

The Social Setting

The public mood is very favorable, but may be riding for a fall akin to consumer spending and confidence. Precisely because the level is so high, it is unlikely to be sustained. Also, the President's teflon—his continued high popularity, even when events don't go his way—although far from worn out, shows a few cracks.

The satisfaction of Americans with their personal life continues to be very high (about 80 percent are satisfied). More important, their satisfaction with the state of the nation is at about the 50-percent mark, compared to 35 percent in August, 1983, and 19 percent in November, 1979. There is a general return to commitment to institutions, authority and traditional values. More people—including the young—identify themselves as conservatives; marriage is on the rise; standards in schools and colleges—even SAT scores—are higher; patriotism is "in." There is a sense that the government is neglecting social programs, but there is no alarm about it. Corporate and personal giving are up.

Underneath it all, however, there is a surprisingly high sense of alienation, of general unfocused disaffection. The President is still popular *personally*, but his policies are not. There is some sense that his agenda is no longer dominant; that,

rather than leading, he has grown reactive—for example, the change in policy toward South Africa; the amendment to balance the budget by 1991. His intense campaign to evoke active public support for tax reform failed.

Barring a major international crisis or failing health of the President, where the political-social trends go from here depends on the economy. If a recession enters the scene in 1986, it may reinforce weakening signs in the recent wave of confidence and reconstruction; it would come when political-social waves are cresting, not rising. Alternatively, if economic growth is renewed with vigor, trends of political and social optimism may be extended. Watch how the Republicans do in the 1986 elections for a major clue to where the political-social trends are headed.

The International Political Environment

Paul H. Kreisberg

The international political environment for the United States and for U.S. business is gradually deteriorating. It is not yet really serious, but could easily become so. U.S. policy initiatives could affect this trend in some sectors, but there is no assurance that the overall environment is susceptible to real change in the short to medium term. The three principal variables are:

- The possibility of a new wave of protectionism in the United States that would hurt many of our closest friends around the world, intensify tensions between and among developed and developing states, complicate the handling of international debt issues, and aggravate political unrest in many countries.
- High unemployment in Western Europe, the difficult prospects for reaching accommodation with the European Community on a wide range of trade issues, and underlying unease in many European countries on a variety of security issues, both conventional and nuclear, could contribute to electoral shifts in a number of countries in 1986 toward either labor-socialist governments or more nationalistic ones in the United Kingdom, West Germany, and France. While these would not alter basic alliance relationships, they could raise new problems for the United States in coordinating policies toward the communist states and on global economic issues.
- Uncertainty about U.S.-Soviet relations—and whether these will lead toward relaxation of tensions or heightening of the global arms competition and of regional tension around East-West issues—is particularly high in Europe and elsewhere. Despite recent hints that both sides may be moving closer to a workable negotiating posture for the Gorbachev-Reagan Summit late in November, it is doubtful that the results will satisfy anyone for long and, indeed, they could increase pressures on the United States from a wide variety of directions. For example, deployment of cruise missiles will not be completed until 1989 and allied participation in, and support for, the Strategic Defense Initiative remains uncertain; both of these could become sources of increasing alliance tension. Signs of progress in East-West relations could lead to new European efforts to broaden links with the Soviets and Eastern Europe and to resistance to U.S. urging of greater defense expenditures for new high-technology conventional weapons. Lack of such progress, on the other hand, will intensify debate about the wisdom of U.S. policies not only in Europe—where greater independence of policy actions may be a consequence—but around the world since, rightly or wrongly, the United States is seen as the party most susceptible to external political pressure and the initiator of the current phase of the arms race.

Paul H. Kreisberg

Concern about how the United States uses its power.

Concerns Abroad

How the United States resolves its own structural domestic economic dilemmas will affect the economic and political environment in the most fundamental ways. No one questions the reality of U.S. economic and military power. The dimensions of the defense build-up are universally recognized despite considerable unease over its efficiency and over *how* that power may be used. And the intensity with which the U.S. economy affects the entire international economic order both in monetary and trade terms has been reemphasized again for all countries in the last two years.

But for the first time since World War II (including the 1971 monetary and trade "shocks"), there seems to be widespread international uncertainty that the United States knows how to deal with its own macroeconomic problems. The Seoul World Bank and IMF meeting and communique in October, 1985, helped ease some of these concerns. So did the ministerial decision on currency intervention by treasury and central bank officials a few days earlier. Nevertheless, U.S. budget, debt,

trade and tax debates are the subject of enormous international economic and political concern. The longer they go on without resolution, the greater will be foreign worries over whether the United States *can* resolve them, or at least resolve them without devastating damage to others abroad.

A number of countries with severe debt problems also are fragile democracies—for example, Brazil, Argentina, Mexico and The Philippines. These face economic and political crises if U.S. economic decisions trend toward protectionism, higher interest rates, and either inflation or deflation. The urge to find some external source to blame for domestic disasters will be intense, and none of these states will long delay in singling out the United States as responsible. Thus, U.S. political and security interests could be severely impaired.

Some other countries that have grown accustomed to high growth rates and that are heavily dependent both on continuing domestic industrial growth and on exports to the United States—including most of the newly industrialized countries of Asia—could confront serious internal economic and political challenges, if those growth rates remain depressed. Expectations of technology transfers and of investments in a number of these countries may also be disappointed. Resentment of the United States could surge throughout the Asian region, including China and Japan, and regional competition for both markets and investments could disrupt good intraregional relations as well as economic development.

The stability of U.S.-Japan relations is based on deep national interests on both sides, but it is abundantly evident that strains on the relationship are increasing and its tensile strength is not infinite. Even though the Japanese have now moved in some major ways to respond to U.S. political and economic concerns, Japanese reforms may be insufficient to meet U.S. political needs. The U.S.-Chinese relationship also remains more fragile than the constant flow of visitors, the rhetoric of friendship (more evident on the U.S. side than the Chinese), and the growth of trade in the last few years (slowing in 1985) might imply. There would be few more powerful shocks to the international political and economic environment than a broad sense in Asia that the United States was insensitive to the interests of the states of this region.

In a totally different respect, South Africa raises major questions of race and politics, not only throughout the developing world but within the United States and the United Kingdom. Violent racial conflict in South Africa has become an increasingly threatening prospect in 1985, and could easily have consequences going far beyond formal government or international economic relations with that area to affect civic order, race relations, and corporate policies in many countries.

The overall international political scene is one that should be cause for some concern and for the most careful monitoring by anyone with interests in international political and economic relationships.

An Accelerating Expansion

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Some signs of a significant acceleration of economic growth emerged during October—the employment report, the leading indicators, and some anecdotal evidence from our industry analysts. The tone of the published economic data, however, seems to be shifting almost monthly, whipsawing many forecasters. As a result, more durable projections are likely to be based on assessments of the underlying degree of stimulus to business from fiscal and monetary policies and of conditions in the major sectors of the economy.

The federal deficit (unified budget) increased by $27 billion between fiscal 1984 and the fiscal year ending last September. The cyclically adjusted (or structural) deficit also increased by around $30 billion. That compares with $52-billion and $34-billion increases in fiscal 1983 and 1984, respectively. Therefore, the traditional gauge of fiscal policy's stimulus to growth of demand—the increase in the cyclically adjusted deficit—has been falling.

More importantly, restrictive fiscal policies in major foreign economies are offsetting some of the stimulus to domestic GNP growth from U.S. policies. Slower economic growth abroad reduces the expansion of U.S. exports. In addition,

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Forecast above the consensus.

floating foreign-exchange rates heighten the attention that must be paid to economic policies abroad in evaluating the *net* stimulus to U.S. growth from domestic fiscal and monetary actions. Relatively restrictive foreign fiscal policies can contribute to the incentives for capital to move to the United States by dampening investment opportunities abroad. The resulting upward pressure on the dollar exchange rate increases the drag of a rising foreign-trade deficit on U.S. economic growth.